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No. 182

In the Supreme Court of the United States

OCTOBER TERM, 1932

PINELLAS ICE AND COLD STORAGE COMPANY, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 30–34) is reported in 21 B. T. A. 425. The opinion of the Circuit Court of Appeals (R. 42–45) is reported in 57 F. (2d) 188.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered March 29, 1932. (R. 45.) The petition for certiorari was filed June 27, 1932. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Petitioner, a corporation, transferred substantially all its property to another corporation in return for a cash down payment and deferred installments, the latter being evidenced by notes of the transferee secured by its bonds. The question is whether petitioner is relieved from taxation on the gain realized from the transaction by the exceptions to Section 203 (a) of the Revenue Act of 1926, *infra*, pp. 13–17.

STATUTES INVOLVED AND REGULATIONS

These are printed in ~~the~~ Appendix A, *infra*, pp. 13–19.

STATEMENT

This was a petition to the Circuit Court of Appeals for the Fifth Circuit to review an order of the Board of Tax Appeals upholding respondent's determination of a deficiency of $74,673.50 in petitioner's income taxes for 1926. The facts found by the Board of Tax Appeals (R. 22–30) may be summarized as follows:

Petitioner, a Florida corporation, was engaged in the manufacture and sale of ice. Substantially the same stockholders controlled it and the Citizens Ice & Cold Storage Company, a corporation engaged in the same business in the same locality. (R. 22.) The directors and stockholders of both companies were anxious to dispose of all the property of the two companies and then to discontinue business, dissolve the corporations, and distribute the proceeds. Pursuant to this plan one Lewis,

general manager of both companies, in 1926 began negotiations for the sale of the business and property of the two companies. (R. 22–23.)

By written agreement of November 4, 1926, petitioner agreed to sell to the National Public Service Corporation more than 99% of its total property for $1,400,000, of which $400,000 was to be paid in 1926 and the remainder in installments during 1927. (R. 23–25, 30.) The purchaser agreed to form a new Florida corporation and to cause it to take title to the property sold. (R. 26.) The deferred installments of the purchase price were to be evidenced by notes of either the National Corporation or the new corporation, secured by the mortgage bonds of the new corporation or other satisfactory collateral. (R. 25.) An agreement of similar import was executed by the Citizens Company and the National Corporation. (R. 27.)

The National Corporation then organized the Florida West Coast Ice Company (R. 27), and on December 17, 1926, the transactions were closed. Petitioner and the Citizens Company delivered instruments of transfer made out to the Florida Company; cash was paid as provided; and notes of the Florida Company were given for the deferred installments. Bonds of the Florida Company secured by the properties acquired from petitioner and the Citizens Company were given as collateral for the notes. The cash was used to pay petitioner's creditors. The Citizens Company

agreement was carried out at the same time. (R. 27–28.)

In January, 1927, pursuant to the plan mentioned above, the stockholders and directors of petitioner and the Citizens Company adopted formal resolutions for the dissolution of the corporations and the distribution of their assets. When the Florida Company paid its notes to petitioner, the proceeds were immediately distributed to its stockholders as liquidating dividends. After retaining a small sum to meet contingent liabilities, the remaining assets of petitioner (less than 1%) were turned over to a holding company organized in 1927, as trustee for petitioner's stockholders. (R. 29–30.)

The Commissioner determined that petitioner had realized a profit of $552,144.12 on the transaction, and accordingly asserted the deficiency in question. (R. 30.) This action was upheld by the Board (R. 30–34) and the Circuit Court of Appeals (R. 42–45).

ARGUMENT

Section 203 (a) of the Revenue Act of 1926 (*infra*, p. 13) provides that upon the sale or exchange of property the entire amount of the gain or loss shall be recognized, except as specifically provided in later subdivisions of the same section. Section 203 (b) (3) (*infra*, p. 14) provides that no gain or loss shall be recognized if a corporation a

party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization. Section 203 (e) (1) (*infra*, p. 15) provides that if an exchange would be within the provisions of Section 203 (b) (3) but for the fact that the property received in exchange consists not only of stock or securities but also of other property or money, then if such other property or money is distributed in pursuance of the plan of reorganization no gain to the corporation is to be recognized from the exchange. Section 203 (h) (1) (*infra*, p. 16) defines the word "reorganization."

It is thus apparent that the following elements must coexist in order to make a transaction nontaxable within Section 203 (e) (1): A plan of reorganization; an exchange for stock or securities and other property (not a sale for money only); a reorganization to which the corporation seeking exemption from tax is a party; and distribution of the cash or other property pursuant to the plan of reorganization. If any one of these elements is lacking, the transaction does not fall within the exception and is therefore taxable. Petitioner contends that all these elements are present in the instant case.

The Board of Tax Appeals interpreted the contract, pursuant to which petitioner's property was

disposed of, as providing for a sale of the property for money. It pointed out that the consideration for petitioner's property was to be paid in cash and that the notes received by petitioner were merely evidence of deferred payments to be made in cash and were not themselves received as payment. It therefore held that the transaction was not an exchange for cash and securities within Section 203 (e) (1). (R. 30–34.) We believe that the Board's interpretation of the transaction as not being an exchange for cash and securities was correct, and that that is an adequate ground upon which to rest the case. There is no conflict of decisions with respect to this ground, and we submit that the question of the proper interpretation of the transaction is not of sufficient general importance to warrant review by this Court. The grounds upon which the court below placed its decision are discussed *infra*, pp. 9–12.

Petitioner contends that the statute, read in the light of its legislative history and administrative interpretation, does not distinguish between sale and exchange. But we are not now concerned with the question whether Congress intended to make a technical distinction between sales and exchanges. Our position is that one of the requisites provided by the statute is that the consideration for the transfer of assets shall consist of stock or securities in addition to cash or other property, and that the transaction involved in the present case does not

satisfy this requirement. As we shall show, both the legislative history of the statute and the administrative interpretation state this requirement.

In support of its contention petitioner quotes from what it states to be the legislative history of Section 203 of the Revenue Act of 1924 (43 Stat. 253, 256, U. S. C. Title 26, Sec. 934), which was identical with Section 203 of the 1926 Act. (Pet. Br. 15–16.) It is true that the Statement of Changes Made in the Revenue Act of 1921, which was prepared by the Treasury Department, supports the view that a transfer of assets for cash may be nontaxable. But it does not appear that this report was accepted by the Senate or House; and petitioner's quotation from the report of the House Committee on Ways and Means (Pet. Br. 16) shows that Congress took a contrary view by limiting Section 203 (e) (1) to transfers "for stock and securities * * * *and* cash." (Italics ours.)

Although it does not appear from petitioner's abbreviated quotations of the Regulations (Pet. Br. 17–19), the requirement that stock or securities in addition to cash or other property be received in exchange for the transfer of the assets is retained in them. Thus, Article 1574 of Regulations 69, after setting out the hypothetical cases quoted by petitioner (Pet. Br. 18–19), provides—

> then no taxable income is received from the transaction by corporation A or B *if the sole consideration for the transfer of the assets is stock or securities of corporation A or B;* and no taxable income is received from the transaction by the shareholders of either

corporation A or corporation B *if the sole consideration received by the shareholders is stock or securities of corporation A or B.* (Italics ours.)

A similar limitation is contained in Article 1574 of Regulations 65, quoted in part by petitioner. (Pet. Br. 17–18.) As these Regulations obviously deal with transfers for which the sole consideration is stock or securities, they would seem to have no bearing upon the present case. There is no Regulation which provides that a transfer in return for cash alone is exempted from taxation by Section 203.

Article 1575 of Regulations 65 and 69 (*infra*, pp. 17–19) deals with transfers in consideration of stock ~~and~~ securities *and* other property and provides that transfers of property in return for stock or securities *and* money or other property, where all the other conditions of the statute are satisfied, are nontaxable if the other property or money received is distributed pursuant to the plan of reorganization. The administrative rulings cited by petitioner (Pet. Br. 19, 23) also do not help it.[1]

[1] In G. C. M. 3827, VII–2 C. B. 114, the taxpayer transferred its business in exchange for preferred stock and cash. In G. C. M. 7472, IX–1 C. B. 184, assets were exchanged for stock. In I. T. 2542, IX–2 C. B. 126, stock was exchanged for stock. In G. C. M. 3291, VII–1 C. B. 203, stock in one corporation was exchanged for stock and debenture notes in another. While G. C. M. 2000, VI–2 C. B. 248, held farmers' mortgage notes to be securities under the Federal Farm Loan Act, the question arose under Section 234 (a) (2) of the Revenue Act of 1921, and no question was raised with respect to transfers under Section 203. In G. C. M. 8565, IX–2 C. B. 127, the gain upon the transaction was held taxable.

We submit that, as the Board has held (R. 32–33), the transfer in this case does not come within the statute (or the Regulations) since the consideration was not stock or securities in addition to cash. Petitioner transferred its assets in return for a down payment in cash and deferred installments of the purchase price to be paid in cash. At the time of the transfer petitioner received notes of the transferee in the amount of the deferred installments. But these notes were not "securities" within the statute, since it was expressly agreed between the parties that the notes were given merely to evidence the deferred installments of the purchase price, which under the contract of November 4, 1926, were required to be paid in cash. As the notes were not accepted as payment, but merely as evidence of the deferred payments, it is unnecessary to discuss whether notes may be securities within the statute when they are themselves accepted as payment. Since one of the requirements of Section 203 (c) (1), receipt of stock or securities, was lacking, we submit that the Commissioner correctly held the transaction involved in the present case to be taxable.

The Circuit Court of Appeals apparently considered that the transaction was a sale and not an exchange, but went on to point out that a "reorganization" is an essential element in the transaction which constitutes a tax-free exchange under the statute, and that in the case at bar, although there was an acquisition by one corporation of substantially all the property of the other, there was no

reorganization because the transaction was not of the nature of a "merger" or "consolidation," as those words are generally understood.

We are informed that the consistent administrative construction of Section 203 (h) (1) (A) by the Treasury Department has always been that the acquisition of substantially all the property of a corporation is a "reorganization" within the meaning of the statute, provided the other conditions of the statute are met. We are also informed by the Treasury Department that in thus construing the statute it has attempted to give proper effect to the parenthetical clause in Section 203 (h)(1)(A) and, therefore, has not been and is not restricting the meaning of Section 203 (h)(1)(A) in accordance with the conclusion of the court below, in so far as it may be regarded as giving no effect to the parenthetical clause.

Section 203 (h) (1) (A) was recently under consideration by the Circuit Court of Appeals for the Second Circuit in *Cortland Specialty Co.* v. *Burnet,* decided July 29, 1932, which is printed in full in Appendix B, *infra,* pp. 20–29. The court there held that there is a "reorganization" within the meaning of the statute if after a transfer by one corporation to another of substantially all its property, the transferor continues to have some interest in the property of the transferee. Except in so far as it held that short-term negotiable notes did not give such an interest, the Second Circuit has left open the question of the nature of the interest of the transferor which is necessary to make

a transaction a reorganization within the statute. Although citing the decision of the court below in the instant case with approval, the court in the *Cortland Specialty Co.* case does not seem to have limited Section 203 (h) (1) (A) to cases where there is a technical merger or consolidation.

While as set forth above the court below apparently placed its decision on the ground that a technical merger or consolidation is necessary to a reorganization under Section 203 (h) (1) (A), the limits of the decision are not entirely clear. If the opinion below should be construed as meaning that a reorganization within the statute exists if there be a continuity of interest, then it is in harmony with the views of the Circuit Court of Appeals for the Second Circuit. If, on the other hand, it should be construed as requiring a merger or consolidation in the technical sense, then it is to that extent in conflict with administrative construction and with the decision of the Second Circuit.

We are informed by the Treasury Department that the question whether a transfer of substantially all the property of a corporation without a technical merger or consolidation is a "reorganization" within Section 203, is one of importance in the administration of the law, as a large number of cases have already been disposed of by the Bureau of Internal Revenue upon the basis of the administrative construction mentioned above and the question is involved in many matters pending in the Bureau. In view of this fact and of the pos-

sible conflict of the decision below with the consistent administrative construction and the decision of the Second Circuit and the resulting confusion, we should not oppose the instant petition were it not that the case may be adequately rested on the ground stated by the Board of Tax Appeals and discussed above, which we believe correct and as to which there is no conflict of decisions. It therefore appears that if certiorari were granted in the present case, it could be decided on that ground without consideration of the definition of "reorganization" in Section 203 (h) (1) (A). Hence we oppose the instant petition, although we feel that the question of the proper interpretation of Section 203 (h) (1) (A), outlined above, is one of sufficient general importance to merit review by this court.

CONCLUSION

The petition should be denied for the reasons above stated.

Respectfully submitted.

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AUGUST, 1932.

APPENDIX A

Revenue Act of 1926, c. 27, 44 Stat. 9, 11, 12, 13, 14:

SEC. 202. (a) Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the basis provided in subdivision (a) or (b) of section 204, and the loss shall be the excess of such basis over the amount realized.

* * * * *

(d) In the case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purposes of this title, shall be determined under the provisions of section 203.

* * * * *

[U. S. C. Sup. V, Title 26, Sec. 933.]

SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

(b) (1) No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates of trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade

or business or for investment, or if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

(2) No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

(3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

* * * * *

(c) If there is distributed, in pursuance of a plan of reorganization, to a shareholder in a corporation a party to the reorganization, stock or securities in such corporation or in another corporation a party to the reorganization, without the surrender by such shareholder of stock or securities in such a corporation, no gain to the distributee from

the receipt of such stock or securities shall be recognized.

(d) (1) If an exchange would be within the provisions of paragraph (1), (2), or (4) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property.

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, but

(2) If the corporation receiving such other property or money does not distribute it in pursuance of the plan of reorganization, the gain, if any, to the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

(f) If an exchange would be within the provisions of paragraph (1), (2), (3), or (4) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain or loss, but also of other property or money, then no loss from the exchange shall be recognized.

(g) The distribution, in pursuance of a plan of reorganization, by or on behalf of a corporation a party to the reorganization, of its stock or securities or stock or securities in a corporation a party to the reorganization, shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of section 201 for the purpose of determining the taxability of subsequent distributions by the corporation.

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after

the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

(i) As used in this section, the term "control" means the ownership of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of the corporation.

[U. S. C. Sup. V, Title 26, Sec. 934.]

Article 1575 of Treasury Regulations 69, under the Revenue Act of 1926, is as follows:

Exchanges in reorganizations for stock or securities and other property or money. If stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged for stock or securities in such corporation or in another corporation a party to the reorganiation and other property or money, the gain, if any, to the recipient will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property. No loss from such an exchange will be recognized, however. (See section 203 (f).) If a distribution of property or money in the course of a reorganization is otherwise within the provisions of this para-

graph, but has the effect of the distribution of a taxable dividend, there shall be taxed to each distributee (1) as a divided, such an amount of the gain recognized under this paragraph as is not in excess of the distributee's ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913, and (2) as a gain from the exchange of property, the remainder of the gain recognized under this paragraph.

Examples.—(1) A, in connection with a reorganization, exchanges in 1925 a share of stock in the X company, purchased in 1918 for $100, for (a) a share of stock in the Y company a party to the reorganization, which has a fair market value of $90, and (b) $20 cash. The gain from the transaction, $10, is recognized and taxed to A. See article 1596 for the basis for determining gain or loss from a subsequent sale.

(2) The X corporation has a capital of $100,000 and earnings and profits of $50,000 accumulated since February 28, 1913. The X corporation in 1925 transfers all its assets to the Y corporation in exchange for the issuance of all Y's stock and the payment of $50,000 in cash to the shareholders of corporation X. A, who owns one share of stock in X, for which he paid $100, receives a share of stock in Y worth $100 and in addition $50 in cash. A will be liable to the surtax on $50.

If, in pursuance of a plan of reorganization, property is exchanged by a corporation a party to a reorganization for stock or securities in another corporation a party to the reorganization and other property or money, then, if the other property or money

> received by the corporation is distributed by it pursuant to the plan of reorganization, no gain to the corporation will be recognized. If the other property or money received by the corporation is not distributed by it pursuant to the plan of reorganization, the gain, if any, to the corporation from the exchange will be recognized in an amount not in excess of the sum of the money and the fair market value of the other property so received which is not distributed. In either case no loss from the exchange will be recognized. (See section 203 (f).)

Article 1575 of Treasury Regulations 65, under the 1924 Act, is substantially identical with the above.

APPENDIX B

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Cortland Specialty Company, Mrs. H. R. Sargent, H. R. Sargent, Petitioners, *against* Commissioner of Internal Revenue, Respondent

OPINION RENDERED JULY 29, 1932

Before: L. HAND, AUGUSTUS N. HAND AND CHASE, *Circuit Judges.*

Appeal from orders of the United States Board of Tax Appeals.

From orders of the Board of Tax Appeals determining a tax deficiency of $13,412.82 against the petitioners Cortland Specialty Company, Mrs. H. R. Sargent and H. R. Sargent, respectively, each of said petitioners appeals. Affirmed.

AUGUSTUS N. HAND, *Circuit Judge:*

The question raised by this appeal is whether the transfer by Cortland Specialty Company to Deyo Oil Company, Inc., hereinafter described was a reorganization within the meaning of Section 203 (h) (1) of the Revenue Act of 1926 which relieved the Cortland Company from paying an income tax upon any gain that might result therefrom or whether the transfer was a mere sale which subjected the transferor to a tax on any profit which it realized. The Cortland Company made its return

upon the theory that the transfer was in effect a reorganization. The Commissioner held that it was nothing but a sale and assessed a tax deficiency against it for the year 1925 in the sum of $13,412.82 because of a profit of $101,175.58 over the depreciated cost of the property transferred. A similar tax deficiency was assessed against Mr. and Mrs. Sargent as transferees of the assets of the Cortland Company. Their liability is undisputed in case that of the Company should stand. The Board of Tax Appeals affirmed the action of the Commissioner.

During the year 1925 the Cortland Company was engaged in the business of buying and selling petroleum products. Herbert R. Sargent and his wife Bertha C. Sargent were the sole owners of its stock. Mr. Sargent was the president, treasurer, and general manager, and Mrs. Sargent was the secretary. The Deyo Oil Company was a corporation engaged in the same business and each of the companies were New York corporations. On September 26, 1925, agreements were entered into between the Cortland Company and Deyo Company, and by Sargent and the latter, whereby the greater part of the assets of the Cortland Company were turned over to the Deyo Company, the Cortland Company agreed to discontinue business after October 1, 1925, and Sargent became the general manager of the business of the Deyo Company in the territory previously served by the Cortland Company. The assets to be transferred under the contract were:

(1) Real property, leases, and physical equipment of Cortland.

(2) Merchantable petroleum products of Cortland.

The consideration for the transfer, according to the contract, was:

Payments by Deyo for real property, leases and physical equipment of business made under Articles "First" and "Third" of the contract of transfer:

Cash		$53,070.00
Promissory notes of Deyo, each dated October 1, 1925, and payable:		
December 1, 1925	$35,500.00	
January 1, 1926	21,300.00	
March 1, 1926	26,625.00	
June 1, 1926	26,625.00	
September 1, 1926	26,625.00	
December 1, 1926	23,075.00	
Total notes		159,750.00
		212,820.00
Payment by Deyo, on October 9, 1925, for merchantable petroleum products purchased from Cortland under Article "Fourth" of the Contract		23,803.82
Total receipts by Cortland on account of transfer		236,623.82

The $53,070 of cash paid by Deyo to Cortland, and the $159,750 in notes of Deyo, were distributed by Cortland to Mr. and Mrs. Sargent, its sole stockholders, shortly after the transfer occurred. They collected the notes as they fell due, the note for $21,300 payable December 1, 1925, on that date, and the remaining notes when they matured in 1926.

The Cortland Company proceeded to liquidate its accounts receivable and trade notes and other property not included in the transfer to Deyo, to pay its debts, and in general to prepare for dissolution which occurred June 30, 1926.

The following assets of Cortland were not transferable to Deyo under the contract with the latter:

Accounts and trade notes receivable amounting to about	$60,000.00
Stock of garage company valued at	4,000.00
Estimated cash on hand, not included in transfer	14,000.00
Total assets not transferred under contract	78,000.00
Amount owing by Cortland to its creditors was	56,000.00
Net amount of assets of Cortland not covered by contract with Deyo	22,000.00

From the foregoing, it is probable that, in view of an immediate proposed distribution by Cortland to its stockholders and of the possibility of poor returns from the $60,000 of accounts, Cortland omitted from the contract the $78,000 of assets in order safely to pay its own creditors, and relied on the assets which it retained and the amount which its petroleum products sold to Deyo would later yield, to care for its existing obligations and for further expenses connected with the transfer and the dissolution proceedings.

The net result of its transactions was to transfer to Deyo assets amounting to $236,623.82, and to withhold net assets from the transfer of $22,000.00; making its total assets at the date of transfer equal $258,623.82.

The foregoing tabulation shows that about 91½% of Cortland's assets were transferred to Deyo and only about 8½% were retained. There can be no doubt that by the transfer Deyo acquired substantially all the properties of Cortland and so the Board of Tax Appeals found.

Whether the above transfer of real property, leases, and equipment was a sale resulting in a gain on which Cortland was taxable, or whether it represented an exchange in pursuance of a "plan of reorganization" on which no gain should be recognized, depends on the effect to be given to the

provisions of Section 203 of the Revenue Act of 1926.

It may be said at the outset that the contract of Cortland with Deyo and the corporate resolution authorizing it to be made treat the transfer to the latter as a sale. The instrument begins by reciting that Cortland "has determined * * * to sell and dispose of all its physical and tangible assets" and that Deyo "has determined to purchase said assets." It goes on to say that Cortland "agrees to sell, transfer and convey * * * all and singular its real property, interests in real property, leases of real property * * * and equipment * * *", and later to say that it "shall sell * * * all of the merchantable gasoline, kerosene, oils and other petroleum products" and that Deyo "agrees to pay" the "purchase price of $213,000.00" for the "real property * * * and equipment" and a further "purchase price" to be determined by "an inventory taken at prevailing cost prices" for the "petroleum products." Nothing is said about the acquisition of any vested interest by Cortland or its stockholders in the business or assets of Deyo, but, on the contrary, it is provided that their interest shall be completely severed for, under Article "Fifth" of the contract, Cortland is "not to engage in the business of buying, selling or dealing in gasoline, kerosene or other petroleum products from and after October 1st, 1925" and is to receive nothing but cash and short-time promissory notes as the consideration for the business and property sold. The transaction certainly bore all the characteristics of a simple sale.

But it is argued that under Subdivisions (e) and (e)(1) of Section 203 of the Revenue Act of 1926 "no gain or loss shall be recognized if a corporation, a party to a reorganization" distributes "stock or securities" and "money" "in pursuance of the plan of reorganization," and that under Subdivision (h) (1) (A) of the section the term "reorganization" is defined broadly enough to exempt Cortland from a profit tax on its transfer. In (h) (1) (A) a reorganization is defined as *"a merger or consolidation"* and the subdivision goes on to say that "merger or consolidation" *include* "the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation." If the last clause means that any transfer of "substantially all the properties" of one corporation to another corporation is a reorganization, the position of Cortland is strong; but we do not regard such an interpretation as warranted.

Reorganization, merger, and consolidation are words indicating corporate readjustments of existing interests. They all differ fundamentally from a sale where the vendor corporation parts with its interest for cash and receives nothing more. Reorganization in the most ordinary sense suggests "the formation of a new corporation that is in financial difficulties, for the purpose of purchasing the company's works and other property, after the foreclosure of a mortgage or judicial sale." Morawetz Corp. §812; *Symmes* v. *Union Trust Co.*, 60 Fed. 870. While the term includes

financial readjustments in ways other than by judicial sale it does not properly embrace mere purchases by one company of the assets of another. *Little Rock Chamber of Commerce* v. *Reliable Furniture Co.* (*Ark.*) 211 S. W. 371. Reorganization is defined in (h) (1) (A) as including "a merger or consolidation." A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist and the merging corporation alone survives. A consolidation involves a dissolution of the companies consolidating and a transfer of corporate assets and franchises to a new company. In each case interests of the stockholders and creditors of any company which disappears remain and are retained against the surviving or newly created company. *Railroad Company* v. *Georgia,* 98 U. S. at p. 362; *Matter of Bergdorf,* 206 N. Y. 309; *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 57 Fed. (2d) 188; *Royal Palm Soap Co.* v. *Seaboard Air Line Ry. Co.,* 296 Fed. 448; *Lee* v. *Atlantic Coast Line,* 150 Fed. 775. Undoubtedly such statutes vary in the different states particularly in respect to how far the constituent companies may be deemed to survive the creation of the new or modified corporate structure, but we believe that the general purpose of them all has been to continue the interests of those owning enterprises, which have been merged or consolidated, in another corporate form. A sale of the assets of one corporation to another for cash without the retention of any interest by the seller in the purchaser is quite outside the objects of merger and consolidation statutes.

Section 203 of the Revenue Act of 1926 must be interpreted in this setting. Its purpose was to relieve those interested in corporations from profits taxes in cases where there was only a change in the corporate form in which business was conducted without an actual realization of any gain from an exchange of properties. When describing the kind of change in corporate structure that permits exemption from these taxes, Section 203 does not disregard the necessity of continuity of interests under modified corporate forms. Such is the purpose of the word "reorganization" in Sec. 203 (b) (3) where a corporation exchanges its property "solely for stock or securities." Such also is the nature of the "merger or consolidation" described in (h) (1) (A) where a corporation acquires a majority of the stock of another, and such is the nature of the "reorganization" described in (h) (1) (B) where a corporation transfers assets to another corporation and the transferor, or its stockholders, immediately thereafter are in control of the transferee. The words: "A recapitalization," in (h) (1) (C) and "A mere change in * * * form * * * of reorganization however effected" in (h) (1) (D) involve the same idea.

When Subdivision (h) (1) (A) included in its definition of "merger or consolidation" the "acquisition by one corporation of * * * substantially all the properties of another", it did this so that the receipt of property by the corporation surviving the merger might serve to effect a reorganization as does an acquisition of stock. Each transaction presupposed a continuance of interest on the part of the transferor in the properties transferred. Such a limitation inheres in the conventional meaning of

"merger and consolidation" and is implicit in almost every line of Section 203 which we have quoted. In *Pinellas Ice & Cold Storage Co.* v. *Commissioner,* 57 Fed. (2d) 188, the Court of Appeals of the Fifth Circuit decided that a transaction almost exactly like the present was not a "merger or consolidation" but a mere sale carrying no exemption. Judge Groner's opinion in *Corbett* v. *Burnett,* 50 Fed. (2d) 492, is in accord. In defining "reorganization", Section 203 of the Revenue Act gives the widest room for all kinds of changes in corporate structure but does not abandon the primary requisite that there must be some continuity of interest on the part of the transferor corporation or its stockholders in order to secure exemption. Reorganization presupposes continuance of business under modified corporate forms.

Furthermore the Cortland Company can not come within the exception to the general rule that gains realized from exchanges of property represent taxable income unless Sec. 203 (e) and Sec. 203 (e) (1) apply. Under those clauses, even if the transfer to Deyo was an exchange in pursuance of a "plan of reorganization" the property received by Cortland had to include *some* "stock or securities" (Sec. 203 (e)), or the exemption could not be had. As no stock was issued against the transfer, the conditions for an exemption were not fulfilled unless the notes, all payable within fourteen months of the date of the transfer, and all unsecured can be considered "securities" under Section 203 (e). Inasmuch as a transfer made entirely for cash would not be enough, it can not be supposed that anything so near to cash as these notes payable in so short a time and doubtless read-

ily marketable would meet the legislative requirements.

The very reason that Section 203 (e) requires that some of the property received in exchange should be *"stock or securities"* is to deprive a mere sale for cash of the benefits of an exemption and to require an amalgamation of the existing interests. There can be no justice or propriety in taxing one corporation who transfers its properties for cash and in relieving another that takes part of its pay in short time notes. The situation might be different had the "securities," though not in stock, created such obligations as to give creditors or others some assured participation in the properties of the transferee corporation. The word "securities" was used so as not to defeat the exemption in cases where the interest of the transferor was carried over to the new corporation in some form.

It seems unnecessary to say that the contract whereby Sargent went into the employment of Deyo for one year as manager in the business territory formerly occupied by Cortland did not place Cortland or its stockholders in control of Deyo in such a way as to effect a reorganization within the meaning of Section 203 (h) (1) (B).

The orders of the Board of Tax Appeals are affirmed.

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